Supreme Court, U.S.
FILED

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No.

In The

Supreme Court of the United States

October Term, 1996

JACK L. AND RUTH A. FIRSDON,

Petitioners,

vs.

INTERNAL REVENUE SERVICE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Where debtors/taxpayers succeed to a net operating loss upon the close of a bankruptcy estate, may the IRS seek to later reduce that net operating loss by the amount of cancelled debt when 26 U.S.C. § 108 and 11 U.S.C. § 505 both require such action to be undertaken in the bankruptcy court with jurisdiction over the underlying chapter 7 case administration?

II. Where a claim for refund of the overpayment of federal income taxes would be barred by the statute of limitations set forth in 26 U.S.C. § 6511, does 11 U.S.C. § 346 operate to toll that limitations period during the pendency of a bankruptcy proceeding that has lasted as long as the case at bar?

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Petitioners, Jack L. and Ruth A. Firsdon, respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 95 F.3d 444 (1996) and is reproduced in the Appendix filed herewith ("App.") at 1a-10a . The unreported opinion of the district court in is reproduced in the appendix filed herewith at 11a-20a.

STATEMENT OF JURISDICTION

The Court of Appeals entered its judgment on September 12, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(l).

STATUTES INVOLVED

The pertinent provisions of 11 U.S.C. § 346, 11 U.S.C. § 505, 26 U.S.C. § 108 and 26 U.S.C. § 6511 are reproduced in the appendix filed herewith at 21a-30a.

STATEMENT OF THE CASE

Petitioners, Jack L. Firsdon and Ruth A. Firsdon have worked as a municipal fireman for twenty-five years and a university secretary for over nine years, respectively. They had also operated a successful farming business up until 1982.

Unfortunately, due to successive bad harvests coupled with the failure of a grain storage system, Mr. & Mrs. Firsdon found it necessary to file for protection under Chapter 11 of the bankruptcy code, in March of 1982. Through this reorganization, they had hoped to honor all of their debts to the fullest extent

possible, and continue their family farming business. However, due to ineffective assistance of counsel, negligence of the original bankruptcy trustee and creditor misconduct violative of the automatic stay, the latter being the subject of pending case(s) in the state courts, the Firsdons were forced to convert their Chapter 11 case to a Chapter 7 liquidation proceeding, in October of 1985. The Chapter 7 portion of their bankruptcy pended for over five and a half years. It was not until December 4, 1991 that the bankruptcy court entered a final decree in this matter. Thus, through no fault of their own, the Firsdon's endured an extraordinarily lengthy bankruptcy estate proceeding of almost ten (10) years.

Furthermore, it was not until May 15, 1991 that the trustee of the bankruptcy estate filed the final bankruptcy estate income tax return, form 1041, for the 1989 tax year, along with estate returns for the tax years of 1982, 1983, 1984, 1985, 1986 and 1988. The 1989 return recorded a final liquidated net operating loss carry forward ("NOL") of Three Hundred Forty Five Thousand Four Hundred Twenty Four ($345,424) Dollars. Pursuant to 11 U.S.C. § 505(b), the Trustee requested a prompt tax audit of the estate's return(s). In a letter dated June 3, 1991, the IRS "accepted the returns as filed."

Subsequently, on June 4, 1991, the bankruptcy trustee abandoned the estate's remaining assets, including its tax attributes, to the Firsdons. It was on that date that the Firsdons were first able to utilize the estate's unused NOLS. Within weeks, on July 10, 1991, the Firsdons filed amended joint individual income tax returns seeking refunds of Fourteen Thousand Five Hundred Sixty Eight ($14,568) Dollars, based on the NOLs to which they succeeded upon the termination of the bankruptcy estate under 11 U.S.C. § 346(i)(2) and 26 U.S.C. §§ 1398(g) and (i).

On September 16, 1991, the IRS disallowed the Firsdons' claims for refund for the 1986 through 1989 taxable years. Subsequent to that date, the Firsdons and the IRS executed an agreement to extend the time in which the Firsdons could bring suit to recover their taxes. Within the timeframe outlined in the extension agreement, the Firsdons initiated this suit, on January 3, 1994, in the United States District Court for the Northern District of Ohio, Western Division, for a refund of their federal income taxes.

During the proceedings in the lower court, the parties filed cross-motions for summary judgment. Siding with the IRS, the district court denied the Firsdons their income tax refunds for their tax years of 1986 and 1987, on the basis that they were time-barred. The court also denied the Firsdons their income tax refunds for their 1988 and 1989 taxable years based on the court's interpretation of the Internal Revenue Code and its reading of those bankruptcy court records before it. There had been no ruling in the Firsdons' bankruptcy proceeding that determined any amount of the debts discharged. The district court considered a "Judge's Worksheet" and the Schedule of Claims and appeared to estimate that the debts exceeded the NOLS. Because it did not approve of the result reached by operation of 26 U.S.C. § 108, the court balked at applying the statute in favor of the Firsdons.

On appeal, the United States Court of Appeals for the Sixth Circuit, affirmed the decision of the district court. The court held that the claims for refund for the 1986 and 1987 tax years were time-barred pursuant to 26 U.S.C. § 6511 and that the statute of limitations was not tolled by 11 U.S.C. § 346(i)(2). In denying the remaining claims for refund, the court held that there were no NOLs available for the Firsdons to utilize. The Sixth Circuit based its decision on its interpretation of 26 U.S.C. § 108 and 11 U.S.C. § 505. It refused to allow the Firsdons to

benefit from the operation of the statutes and reduced the net operating loss reported by the bankruptcy trustee on the estate's tax returns by the district court's interpretation of the amount of discharged debt.

REASONS FOR GRANTING THE WRIT

This Court should grant the writ in order to decide important questions of federal law concerning the interrelationship between the Internal Revenue Code and the Bankruptcy Code which have not been, but should be, settled by the Supreme Court.

The interrelationship between 11 U.S.C. § 505 and 26 U.S.C. § 108 is an extremely important question of federal law which directly affects the proper and efficient administration of the Internal Revenue Code and the Bankruptcy Code. Moreover, the proper interpretation of the tolling provisions of 11 U.S.C. § 346 and 26 U.S.C. § 6511 is equally important to the administration of the bankruptcy and tax laws.

Without specific guidance from the Supreme Court, the lower courts may be forced to resort to strained interpretations of the law in efforts to give effect to each courts' interpretation of the purpose of the statutes in question.

Over fifteen (15) years ago, Congress enacted the Bankruptcy Tax Act of 1980. It was widely anticipated that this legislation would bridge the gap between the Internal Revenue Code and the special tax provisions of the Bankruptcy Code. While successful in many regards, the relationship between certain section of Title 26 and Title 11 is not always easily comprehensible and the lower courts have not always been successful in their implementation of the statutory scheme. This has left the law in a state of uncertainty, creating a serious

potential for erroneous and conflicting decisions among the federal circuit courts of appeals and the other lower courts.

The decision by the United States Court of Appeals for the Sixth Circuit in this case demonstrates the propensity for serious errors and miscarriages of justice caused by the unsettled nature of the law in this field.

I.

WHERE DEBTORS/TAXPAYERS SUCCEED TO A NET OPERATING LOSS UPON THE CLOSE OF A BANKRUPTCY ESTATE, THE IRS MAY NOT SEEK TO LATER REDUCE THAT NET OPERATING LOSS BY THE AMOUNT OF CANCELLED DEBT WHEN 26 U.S.C. § 108 AND 11 U.S.C. § 505 BOTH REQUIRE SUCH ACTION TO BE UNDERTAKEN IN THE BANKRUPTCY COURT WITH JURISDICTION OVER THE UNDERLYING CHAPTER 7 CASE ADMINISTRATION.

The Sixth Circuit's opinion in this case blatantly disregards the applicability of 11 U.S.C. § 505 and 26 U.S.C § 108. Substituting its judgment for that of the legislature, the court has refused to apply either statute in favor of the Firsdons, dismissing each in a misguided effort to arrive at what the Sixth Circuit believes should be the proper result in this case. Unwilling to allow the Firsdons to benefit from the law as written, the court, without any supporting authority, has crafted a decision that squarely conflicts with the express provisions of 11 U.S.C. § 505 and 26 U.S.C. § 108.

Operating in conjunction with the Internal Revenue Code, the bankruptcy code sets forth provisions for the determination of the bankruptcy estate's tax liability and, necessarily, its tax attributes, including any NOLS. Specifically, in an effort to

conclusively resolve disputes over the tax consequences of a Bankruptcy estate's returns, Congress chose to grant exclusive jurisdiction over such matters to the bankruptcy court overseeing the administration of the estate. 11 U.S.C. § 505(a). Moreover, in consideration of the frequent uncertainty over the tax implications of the estate's returns, Congress also granted the trustee the right to request from the IRS a prompt audit of the estate's tax returns. 11 U.S.C. § 505(b)(1), Committee Report. Once such a request was made, the IRS would be obligated to either "accept the returns" as filed or to notify the trustee and the court that it "desired to audit the returns more fully." Consequently, if there would be any dispute concerning the estate's tax returns, it was to be currently adjudicated by the bankruptcy court. Clearly, under such circumstances, Congress deemed the bankruptcy court to be the tribunal best suited to determine the final tax consequences of the estate's returns.

Congress wisely determined that the grant of jurisdiction, coupled with the provisions for a prompt tax audit, would permit the bankruptcy court to adjudicate the tax consequences of the estate's returns and relieve the trustee and debtors succeeding to the tax attributes unused by the bankruptcy estate of potential post-bankruptcy tax liability based upon the returns. Where the trustee exercised its discretion to request an audit from the Internal Revenue Service, the government would be compelled to examine the returns and to participate in the underlying bankruptcy proceedings if necessary to conclusively resolve any disputes over the potential tax consequences of the returns. In adopting such a statutory scheme, Congress expressed its desire to avoid situations in which the debtors succeeding to the tax attributes unused by the bankruptcy estate would be called upon to defend tax returns which they did not or could not prepare.

Inexorably a part of this process, § 108 establishes the guidelines for determining the tax consequences of the amount of indebtedness discharged in the bankruptcy. 26 U.S.C. § 108.

Although pursuant to § 108(a) the post-bankruptcy debtor's gross income does not include discharge of indebtedness as taxable income, if such discharge occurs in a bankruptcy case, § 108(b) provides that any such amount excluded from gross income under § 108(a) "shall be applied to reduce the tax attributes of the tax payer," including NOLS. I.R.C. § 108(b)(1)(A). Furthermore, under § 108(d)(8), the bankruptcy estate is the party charged with the responsibility for reducing the NOLs by the amount of discharged indebtedness. No other party is obligated to do so. In addition, following the trustee's decision, there were to be no further tax consequences in regards to the amount of discharged indebtedness. In order to do so, the provisions of § 505 of the bankruptcy code operate in concert with 26 U.S.C. § 108 to resolve with finality any dispute over the amount of NOL remaining after the bankruptcy.

In the present case, the bankruptcy trustee filed a final estate tax return showing a NOL of Three Hundred Forty Five Thousand Four Hundred Twenty Four ($345,424) Dollars. Subsequently, the trustee made a proper and timely request to the IRS for prompt audit of the estate's tax returns. This was IRS's first and final opportunity to determine the accuracy of the estate's tax returns, including the amount of the net operating loss. However, the IRS responded to the trustee's request by letter dated June 3, 1991, in which it "accepted the returns as filed." Rather than notify the trustee in the bankruptcy court that it desired to audit the returns more fully, as required by § 505, the IRS attempted to qualify its acceptance of the estate's returns by purportedly preserving a future right to audit those returns. In reality, the IRS simply disregarded the express provisions of 11 U.S.C. § 505(b).

With the statutory request for an audit having taken place, the only proper forum to adjudicate any dispute over the estate's tax returns, and the tax attributes available to the debtors after the bankruptcy estate administration, was clearly the bankruptcy

court. If the IRS intended to contest the amount of the NOL, it was obligated to do so during those proceedings. However, when it "accepted the returns as filed", the IRS necessarily failed to put the trustee or the bankruptcy court on notice that the net operating loss was a disputed item. Accordingly, when the bankruptcy court closed the estate, allowing the Firsdons to succeed to the NOL, the Firsdons rightfully relied upon the finality of the bankruptcy proceedings in filing their claims for refund.

It was only after the close of the Firsdon's bankruptcy proceeding that the IRS first attempted to deny the Firsdons the use of their NOL. Again, if the IRS had desired to contest the amount of the NOL reported by the trustee, it had a duty to conduct a more comprehensive audit and to litigate any subsequent disputes during the underlying bankruptcy proceeding. Instead, the IRS chose to accept the returns as filed, ignoring its duty to complete the audit and resolve any disputes over the returns in the bankruptcy court. Having failed to raise its objections when and where the statute directs, the IRS now seeks to compel the Firsdons to defend the bankruptcy estate's tax returns and the amount of the NOL when they had no input or control over such decisions. This is exactly the type of situation that Congress hoped to avoid when it promulgated the prompt audit requirement in § 505(b).

The statutes were designed to achieve finality for tax purposes and the IRS should not be permitted to frustrate that policy by deliberately attempting to circumvent the statutes. § 108 incontrovertibly requires the trustee to reduce the estates's NOLs by the amount of discharged indebtedness. § 108(b)(5) also allows the bankruptcy estate to reduce its basis in the estate assets, achieving the same result. It is the IRS' responsibility to ensure that the trustee accurately determines the amount of NOL to be reported which will also be available to be passed on to

the debtors, and § 505 mandates that the IRS make that determination following the trustee's request for a prompt audit. Any and all disputes concerning the amount of the NOL are to be resolved only by the bankruptcy court. The IRS cannot be permitted to attempt to frustrate the policies underlying 11 U.S.C. § 505 and 26 U.S.C. § 108 by deliberately attempting to circumvent the statutes and the courts should prevent any such abuses from taking place.

The Sixth Circuit's opinion, however, fails to do so.

II.

WHERE A CLAIM FOR REFUND OF THE OVERPAYMENT OF FEDERAL INCOME TAXES WOULD BE BARRED BY THE STATUTE OF LIMITATIONS SET FORTH IN 26 U.S.C. § 6511, 11 U.S.C. § 346 OPERATES TO TOLL THAT LIMITATIONS PERIOD DURING THE PENDENCY OF A BANKRUPTCY PROCEEDING THAT HAS LASTED AS LONG AS THE CASE AT BAR.

The Firsdons were under a legal disability (*i.e.*, the bankruptcy stay) for the period of time during which the three year statute of limitations period set forth in 26 U.S.C. § 6511 expired. This legal disability prevented them from initiating the procedure for claiming the federal income tax refund that is partially the subject of this appeal until after the bankruptcy proceeding had gone far enough to permit same. The provisions of 11 U.S.C. §§ 346(i)(1) and (2) permit bankruptcy debtors, after completion of the administration of their bankruptcy estate, to proceed to claim refunds for tax attributes not used by the bankruptcy trustee during the administration of the estate "as though the case had not been filed," that is to say, as though the statute of limitations was tolled during the bankruptcy.

While it is correct that a refund claim timely filed with the IRS is a jurisdictional prerequisite to initiating a refund action in the district court, the Sixth Circuit Court of Appeals incorrectly calculated the time frame in which the Firsdons could file their refund claim with the IRS. Based on its interpretation of 11 U.S.C. §§ 346(a) and (i)(2), read in conjunction with 26 U.S.C. § 6511, its purported reading of the legislative history behind the aforementioned bankruptcy law sections, and the Kansas bankruptcy court's decision in *In Re Page*, 163 B.R. 196 (Bkrtcy. D. Kan. 1994), the Sixth Circuit erroneously determined that the Firsdons were time-barred from pursuing their claim for refunds on their 1986 and 1987 amended returns.

There is no dispute as to the facts concerning the filing of the various returns. From the beginning of the bankruptcy period in 1982, until the very end in 1991, the trustee failed to file the estate's tax returns. Ultimately, the trustee filed the estate's tax returns for the tax years 1982-1986 and 1988-89, inclusive. All these estate tax returns were filed on May 15, 1991. The last of several bankruptcy estate returns, that for the estate's 1989 and final federal tax year, indicated a final, total NOL in the amount of $345,424. This was the initial and *only* time that the bankruptcy estate had ever filed any tax returns, and it was only at that time that the Firsdons were capable of utilizing the NOL (*i.e.*, the stay was lifted). Within weeks thereafter, the Firsdons filed their personal claims for refund for the 1986 and 1987 tax years, which were denied by the IRS as untimely.

Siding with the IRS against the Firsdons, the Sixth Circuit affirmed the District Court's improper interpretation of the statute of limitations tolling provision contained in 11 U.S.C. § 346, ruling that it would not operate to counteract the filing time requirements of 26 U.S.C. § 6511(d)(2). That court relied upon the holding of *In Re Page*, 163 B.R. 196, at 197 (Bkrtcy. D. Kan. 1994), the only reported case that has ever considered

the interaction of the two statutory provisions contained in 11 U.S.C. § 346 and 26 U.S.C. § 6511.

However, the Sixth Circuit's decision conflicts with the logical interpretation of 11 U.S.C. § 346 and 26 U.S.C. § 6511, read together, and the underlying purpose of permitting debtor taxpayers to utilize the unused tax attributes of the bankruptcy estate.

11 U.S.C. §§ 346 (a) and (i)(2) read together, state that:

> Except to the extent otherwise provided in this section, subsection . . . (i) . . . of this section apply . . . but subject to the Internal Revenue Code.

It is the last phrase in the quoted portion of the statute which the court misread.

Looking at the Legislative History of the Bankruptcy Reform Act of 1978, P.L. 95-598, in which the provisions of 11 U.S.C. § 346 were last amended, there are two sections that parallel each other, in the interpretation and explanation of the quoted statutory language. In 1978 U.S.C.A.A.N. 6290-6293 at 6291 (the House Report), and 5830-5833 at 5832 (the Senate Report), it states that:

> (11 U.S.C. 346) (s)ubsection (i) (2) indicates that attributes passing from the debtor into an estate that is a separate taxable entity will return to the debtor if unused by the estate. *The debtor is permitted to use any such attribute as though the case had not been commenced.*

(emphasis added).

11 U.S.C. § 346 (i)(2), which the above House and Senate Reports language interprets and explains, reads:

> The debtor is permitted to utilize such tax attributes as though ***any applicable time limitations on such utilization by the debtor were suspended*** *during the time during which the case was pending.*

(emphasis added).

Despite the aforementioned language, the Sixth Circuit relied upon an interpretation of 11 U.S.C. § 346(a) by the court in *Page, supra*, the facts of which differ drastically from the facts of the case at bar.

In *Page, supra*, the facts were significantly distinguishable from the instant case. The tax liability in *Page* was for "trust fund" taxes which were owed by the corporate officer debtor's corporation, and for which the debtor was a "responsible party" under 26 U.S.C. § 6672. The taxpayer in *Page* was culpable, while the Firsdons were innocent bystanders to a mismanaged bankruptcy.

Also very significantly distinguishing the facts of *Page, supra*, is the fact that in that case there was a break in the tolling of the limitations statute. The taxpayer "filed a bankruptcy petition on June 7, 1987, and the case was closed on November 2, 1988. However the case was *reopened* (emphasis added) on July 28, 1989, to administer late-discovered assets and remains open to this date."

That taxpayer had an opportunity to utilize

> *the unused tax attributes within the statutory time period outlined in 26 U.S.C. 6511. The Appellants never had that opportunity, until one month and six days prior to the time they filed their refund claims.*

As the language of the statute and the congressional record indicate an intent to preserve for the debtor-taxpayer an opportunity to utilize the estate's unused tax attributes, accepting the interpretation of the Sixth Circuit and its reliance on *Page, supra*, would thwart the intent of Congress in enacting 11 U.S.C. § 346.

Clearly, the intent of Congress was that the debtor-taxpayer would not be penalized for a long-lasting estate administration, which is exactly what the Sixth Circuit's decision would do. The Firsdons were in no way responsible for the extraordinary length of the underlying bankruptcy proceeding and it would be manifestly unjust to interpret 11 U.S.C. § 346 and 26 U.S.C. § 6511 to operate to timebar their claim for refund.

CONCLUSION

For the reasons stated, the petition for a writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT FILED SEPTEMBER 12, 1996

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 95-3097

JACK L. FIRSDON and RUTH A. FIRSDON,

Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,

Defendant-Appellee.

ON APPEAL from the United States District Court for the Northern District of Ohio

Decided and Filed September 12, 1996

Before: NELSON and MOORE, Circuit Judges; CLELAND, District Judge.*

KAREN NELSON MOORE, Circuit Judge. In this tax refund case, plaintiffs lay claim to net operating loss deductions purportedly left over from their liquidated bankruptcy estate. The district court granted summary judgment for the United States on two grounds: (1) the refund claims for tax years 1986 and 1987 were time barred; (2) no net operating losses remained

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* The Honorable Robert H. Cleland, United States District Judge for the Eastern District of Michigan, sitting by designation.

for the plaintiffs after such losses were reduced by the amount of debt discharged in the estate's bankruptcy proceeding. We agree with the district court, and we affirm.

I. BACKGROUND

Plaintiffs Jack and Ruth Firsdon were employed as a firefighter and secretary, respectively. In addition, they ran their own farm, which generated significant losses from 1981 to 1984. In 1982, the Firsdons filed for reorganization under Chapter 11 of the Bankruptcy Code. In 1985, the case was converted into a Chapter 7 liquidation. The appointed bankruptcy trustee filed the estate's income tax returns for the tax years 1982-86 and 1988-89, while the Firsdons filed their own personal a final net returns. The estates 1989 return showed a final net operating loss (NOL) carryforward of $345,424.00, reflecting the losses incurred from 1981 to 1984.[1]

Shortly after termination of the bankruptcy in 1991, the Firsdons filed amended individual returns for tax years 1986-89, claiming deductions based on the estate's allegedly leftover NOLS. Under section 1398 of the Internal Revenue Code (I.R.C.), the Firsdons succeeded to any unused NOLs of the estate. *See* 26 U.S.C. § 1398(g) & (i). The Internal Revenue Service (I.R.S.) denied the claims, however, stating that they had not been timely filed. The Firsdons then brought a refund action in the district court, and the government responded with two arguments: first, that jurisdiction was lacking over the 1986

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1. Under I.R.C. § 172, a taxpayer is permitted to take a deduction on NOLs properly carried back or forward to the tax year in question. In general, NOLs may be carried back to the three preceding taxable years or carried forward to the fifteen following taxable years. *See* 26 U.S.C. § 172.

and 1987 claims because of the plaintiffs' failure to file within the limitations period set forth in I.R.C. § 6511(a), and second, that the NOLs had not been reduced by the debt discharged in bankruptcy, as required by I.R.C. § 108 (for the 1988 and 1989 claims). There being no genuine issue of material fact, both parties moved for summary judgment. The district court agreed with the government and granted its cross-motion. The Firsdons timely appealed. We review the district court's grant of summary judgment de novo. *Shahid v. Ford Motor Co.*, 76 F.3d 1404, 1408 (6th Cir. 1996).

II. THE 1986 AND 1987 CLAIMS

The district court correctly observed that a refund claim filed with the I.R.S. is a jurisdictional prerequisite to a refund action in the federal district court. *See Firsdon v. United States*, No. 3:93-CV-7726, 1994 WL 773397, at *1 (N.D. Ohio Dec. 20, 1994); 26 U.S.C. § 7422(a). Furthermore, a claim filed with the I.R.S. must be brought within 3 years from the time the return was filed or 2 years from the time the tax was paid," whichever comes later. 26 U.S.C. § 6511(a)[2]. In this case, the Firsdons do not dispute that their 1986 and 1987 refund claims failed to meet the strict requirements of I.R.C. § 6511(a). Therefore, unless

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2. Although the district court cited the carryback provision (§ 6511(d)(2)) instead of the general provision covering carryforwards (§ 6511(a)), the ultimate effect was the same. The longest statutory period the Firsdons could have hoped for under either provision was three years from the filing dates of the returns. *See* 26 U.S.C. § 6511(d)(2).

Contrary to the view advanced by the Firsdons' attorney at oral argument, the attempted transfer of NOLs in this case is properly deemed a carryforward, because the losses were incurred from 1981 to 1984, and the tax years to which the Firsdons wished to carry them were 1986 to 1989.

the time period could somehow have been tolled, the district court did not have subject matter jurisdiction over these claims, and they were properly dismissed.

The Firsdons argue that the statutory period was in fact tolled during the pendency of their bankruptcy proceeding, under section 346(i)(2) of the Bankruptcy Code, 11 U.S.C . § 346(i)(2). Section 346(i)(2), like I.R.C. § 1398(i), provides that at the close of a bankruptcy proceeding, debtors shall succeed to any unused tax attributes (including NOLs) to which the estate originally succeeded at the inception of the proceeding. Unlike I.R.C. § 1398(i), though, 11 U.S.C. § 346(i)(2) goes on to state: "The debtor may utilize such tax attributes as though any applicable time limitations on such utilization by the debtor were suspended during the time during which the case was pending." On its face, this language appears to support the Firsdons' contention that I.R.C. § 6511(a) should have been tolled. The sweep of this sentence is significantly circumscribed, however, by § 346(a), which states:

> Except to the extent otherwise provided in this section, subsections (b), (c), (d), (e), (g), (h), (i), and (j) of this section apply notwithstanding any State or local law imposing a tax, but subject to the Internal Revenue Code of 1986.

11 U.S.C. § 346(a). In this context, "subject to the Internal Revenue Code" essentially means that the named Bankruptcy Code subsections, including the tolling provision in subsection (i), have no effect on the federal tax laws. Such is the holding in *In re Page,* 163 B.R. 196, 197-98 (Bankr. D. Kan. 1994), where the court found § 346(a) "not extremely well-drafted" but clear

enough to make subsection (i) applicable only to state and local laws."

Although *Page* is the only case even remotely on point, it finds full support in the legislative history to which it cites. Apparently, the special tax provisions of the Bankruptcy Reform Act of 1978, including § 346, were originally intended to apply to all types of taxes — local, state, and federal. But during the progress of the bill, it was determined that "a potential jurisdictional conflict" existed between the House Judiciary Committee, to which the bill had been referred, and the Ways and Means Committee, which had jurisdiction over federal tax legislation. A compromise was thus reached whereby the tax provisions were made "inapplicable to Federal taxes," in the hope that comparable federal provisions would be enacted during the subsequent (96th) Congress. H.R. Rep. No. 595, 95th Cong., 1st Sess. 1, 3, 275 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 5965, 6232; *see also* 1A Lawrence P. King, *Collier on Bankruptcy* ¶ 8.03 (15th ed. 1995). Hence, Congress inserted § 346(a). Comparable federal tax provisions were eventually enacted in the Bankruptcy Tax Act of 1980, including I.R.C. § 1398(i), the provision under which the Firsdons are here able to succeed to their estate's unused tax attributes. Notably, however, although I.R.C. § 1398(i) follows 11 U.S.C. § 346(i)(2) in providing for the succession of a bankruptcy estate's tax attributes for *federal* tax purposes, it does not contain any of the tolling language found in the second sentence of § 346(i)(2).

As a consequence, § 346(i)(2) remains inapplicable to the federal tax laws, even though it was originally drafted with those laws in mind. Because Congress specifically amended § 346 in order to make it "subject to" the Internal Revenue Code, plaintiffs cannot rely on § 346(i) to override the statute of limitations found

in I.R.C. § 6511(a).[3] We affirm the district court's summary judgment against the Firsdons on their 1986 and 1987 refund claims.[4]

III. THE 1988 AND 1989 CLAIMS

The Firsdons received a significant tax benefit when their estate filed for bankruptcy and their debts were discharged. Normally, the cancellation of indebtedness counts as gross income to the debtor, on which he or she is fully taxable. I.R.C.

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3. In their reply brief, the Firsdons also press the claim that § 346(i) actually contains an exception to § 346(a). That is, even though § 346(a) identifies § 346(i) as being inapplicable to federal taxes § 346(a) contains the limiting language, "[e]xcept to the extent otherwise provided in this section," and according to the plaintiffs, § 346(i) does so "otherwise provide." Even if we ignore the fundamental circularity of such a reading — in which one statutory subsection limits the applicability of another subsection, but the latter subsection contains a limitation on that limitation which renders the first subsection inapplicable — we simply discern no basis for interpreting § 346(i) to "otherwise provide." Nothing can be found in § 346(i) to indicate that, notwithstanding the explicit limitation in subsection (a), subsection (i) should in fact apply to the provisions of the federal tax code.

4. Plaintiffs are not unreasonable in questioning the utility of keeping the limitations period running while leftover NOLs remain inaccessible to them in the ongoing bankruptcy proceeding. Nevertheless, Congress's intent here is clear, and there is simply no way for plaintiffs to get around it. As the government emphasizes, the United States may only be sued upon its own consent — the statute of limitations " 'constitutes a condition on the waiver of sovereign immunity,' and, as such, 'define[s] the extent of the court's jurisdiction' over . . . an action." Appellee's Br. at 11-12 (citing *United States v. Mottaz*, 476 U.S. 834, 841 (1986)). Without amending § 346 to make it affect I.R.C. § 6511(a), Congress cannot be said to have extended its waiver of immunity in any fashion. At any rate, there is no unfairness here because, as will be explained below, there are no leftover NOLs for the Firsdons to utilize.

§ 61(a)(12). In bankruptcy cases, however, such cancellations are excepted. I.R.C. § 108(a)(1)(A). Therefore, in the instant case, the Firsdons' estate was not taxed on the hundreds of thousands of dollars of debt that were discharged in its bankruptcy proceeding. *See Firsdon,* 1994 WL 773397, at *1; Def.'s Cross-Mot. for Summ. J. at 4 n.2., J.A. at 28.

Section 108(b) of the I.R.C. provides that any amount excluded from gross income under § 108(a) "shall be applied to reduce the tax attributes of the taxpayer," including NOLs. The obvious reason for this provision is to prevent bankrupt debtors from procuring a double benefit from the tax laws — a tax-free cancellation of debt plus favorable tax attributes from the bankrupt estate. For some reason, it does not appear that the bankruptcy trustee in the Firsdons' case reduced the NOLs of the estate by the amount of debt discharged. The estate's 1989 tax return shows an NOL carryover of $345,424.00. J.A. at 78. Given that the plaintiffs' estate had $55,264.16 in priority claims, $1,323,835.94 in secured claims, and $342,579.89 in unsecured claims, but merely $25,029.59 in net receipts and $503,081.00 in property, *see Firsdon,* 1994 WL 773397, at *1; Def's Cross-Mot. for Summ. J. at 4 n.2; J.A. at 66, the only way in which the estate could have retained a properly reduced carryforward of $345,424.00 in 1989 would have been if its NOLs had totaled $1,538,993.30 before reduction.[5] But the Firsdons failed to

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5. Plaintiffs now appear to dispute this amount, saying that there are genuine issues of fact as to how much debt was actually discharged. They cannot do this. At summary judgment, they accepted all of the government's calculations as being "essentially correct." Pls.' Opp'n to Def.'s Cross-Mot. for Summ. J. at 1. Moreover, plaintiffs fail to provide even the hint of an explanation here as to why these numbers might be inaccurate, stating only that the district court's decision "may be in error." Appellants' Br. at 17.

produce any evidence that such enormous and improbable losses were incurred by the estate from 1981 to 1984. The Firsdons failed to show that the bankruptcy trustee reduced the NOLs by *any* amount of canceled debt. Indeed, the far more plausible inference is that the $345,424.00 figure equaled the entire amount of loss, and that if the proper reductions had been made, nothing would have remained for the plaintiffs to carry forward.[6]

The Firsdons try to counter these facts in a number of unpersuasive ways. First, they suggest that the bankruptcy trustee may actually have "properly reduced" the NOLs, and that we must simply assume "the trustee did his job correctly" and "the Bankruptcy Court judge did his job properly." Appellants' Reply Br. at 12. There is no support for such a notion. All of the evidence before the district court suggested that no reduction was made, and to the extent that a contrary conclusion might have been reached, it was the plaintiffs' burden to present evidence rebutting the facts and arguments in the government's motion for summary judgment. In a refund action, the plaintiff

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6. In fact, extra-record evidence submitted by the Firsdons only serves to confirm this inference. The estate's earlier tax returns show amounts of yearly net loss on Form 1040, Schedule F, J.A. at 124, 132, 140, 157, but then they show these identical amounts appearing on the trustee's worksheet calculations of NOL carryovers, J.A. at 135, 142, 150, 162, 163, 168. In other words, the bankruptcy trustee did not reduce the NOLs by the amount of debt discharged — or by any amount — because the reported losses and NOL carryforwards remained exactly the same from year to year. The $345,424.00 figure on the 1989 return reflects the sum of these same, unreduced amounts.

This evidence was not before the district court, but it is not necessary to our judgment, either. After the government raised the argument in its summary judgment motion that the bankruptcy trustee had neglected to reduce the NOLs, this point remained unrebutted in the district court.

bears the ultimate burden of persuasion. *See McDermitt v. United States*, 954 F.2d 1245, 1251 (6th Cir. 1992). Here, that burden was clearly not met.

Second, the Firsdons argue that the government "is collaterally estopped" from challenging the amount of NOLs, because the appellee "approved the return filings, including the net [sic] NOL" in the bankruptcy proceeding. Appellants' Br. at 15-16. This argument also lacks merit. At the very least, collateral estoppel (or "issue preclusion") requires that an issue be "actually litigated" and "necessary to the judgment" in order to apply. *Kane v. Magna Mixer Co.*, 71 F.3d 555, 561 (6th Cir. 1995), *cert. denied*, 116 S. Ct. 1848 (1996). In this case, there is no evidence that the amount of NOLs on the estate's final tax return was a litigated issue. Likewise, there is no evidence that the NOL figure was necessary to the bankruptcy court's judgment. Indeed, it is apparent that the government was completely without incentive to litigate or otherwise dispute the amount, even if it was incorrect, because it would have changed nothing in the estate's tax liabilities — the final amount would still have been zero. This lack of incentive provides even further reason for denying the application of collateral estoppel. *See United States v. Berman*, 884 F.2d 916, 922-23 (6th Cir. 1989).

Third, plaintiffs assert that because the I.R.S. "accepted" the estate's tax returns "as filed," it admitted all amounts contained therein as true and accurate. This is equally unpersuasive. The government points out that the I.R.S. explicitly notified the trustee, in the very next sentence after accepting the returns: "Do not consider this as an examination that resulted in no change to your tax liabilities. You were not examined for these years." I.R.S. Letter to Bankruptcy Trustee, June 3, 1991. In other words, there was no examination of and no admission as to the contents of any of these returns. Besides, even without

this notice, it is highly doubtful that the mere acceptance of returns would have constituted an admission: as mentioned above, the government did not have any reason to concern itself over the numbers in the returns — in the end, they all added up to something translating into zero tax revenue.[7]

It does not matter that I.R.C. § 108 only requires the estate, rather than the succeeding individual taxpayer, to reduce NOLs by the amount of canceled debt. The Firsdons are not entitled to benefit from an erroneous calculation by their predecessor estate. The district court's summary judgment against them on their 1988 and 1989 refund claims was entirely correct.

IV. CONCLUSION

We note that the second rationale in this case — the reduction of NOLs by the amount of canceled debt — provides a basis for affirming the district court's judgment as to the 1986 and 1987 claims, as well as the 1988 and 1989 claims. Nonetheless, because the Firsdons did not satisfy a jurisdictional prerequisite for having the earlier claims heard in federal court, we adopt both of the district court's bases: the statute of limitations in I.R.C. § 6511(a) and the reduction of tax attributes under I.R.C. § 108(b). We **AFFIRM.**

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7. At oral argument, counsel for the Firsdons attempted to buttress this contention by pointing to 11 U.S.C. § 505(b). *See also* Appellants' Br. at 16-17 (referring to § 505(b)). Section 505(b) is of no assistance to the plaintiffs. It provides for a prompt audit procedure on a bankruptcy trustee's tax returns, and it addresses the finality of the amount of an estate's tax liability. However, the provision has nothing to do with the finality of a trustee's NOL calculation, where the calculation itself has no ultimate effect on the amount of the estate's liability. Where, as here, the estate's liability is zero under any NOL figure, the I.R.S. cannot in any sense be bound by the trustee's erroneous NOL figure under § 505(b).

APPENDIX B — OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO, WESTERN DIVISION FILED DECEMBER 20, 1994

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
WESTERN DIVISION

3:93-CV-7726

JACK L. AND RUTH A. FIRSDON,

Plaintiffs

v.

UNITED STATES OF AMERICA,

Defendant

OPINION AND ORDER

This is a tax refund case in which plaintiffs, Jack and Ruth Firsdon, claim a tax refund for tax years 1986 through 1989 in the amount of $14,568.00, plus interest, based on net operating loss deductions ("NOL's") to which plaintiffs claim to have succeeded at the close of a bankruptcy proceeding. Pending are cross-motions for summary judgment. The issues to be resolved are whether: (1) plaintiffs' claims for tax years 1986 and 1987 are time barred, and (2) plaintiffs' NOL carryovers are to be reduced by the amount of debt discharged in their bankruptcy proceedings. I find that no genuine issue of material fact is present with respect to plaintiffs' claims, and grant the United States' motion for summary judgment.

Appendix B

I.

Plaintiffs filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code on March 12, 1982. Plaintiffs' Chapter 11 was converted to a Chapter 7 on October 1, 1985. Plaintiffs had $55,264.16 in priority claims, $1,323,835.94 in secured claims, and $342,579.89 in general unsecured claims. The bankruptcy estate was insufficient to meet all these claims and the remaining debts were discharged.

On May 15, 1991, the bankruptcy trustee filed the final fiduciary income tax return for tax year 1989, reflecting final NOL's for the bankruptcy estate of $345,424.00. Pursuant to Bankruptcy Code §§346(i) (1), (2) and Internal Revenue Code ("I.R.C.") §§1398(g),(i), the debtor-plaintiffs succeeded to these NOL's. Plaintiffs now seek a federal income tax refund for tax years 1986 through 1989 based on these NOL's.

II.

The United States first raises a statute of limitations defense. Defendant contends that plaintiffs' claims for the tax years 1986 and 1987 are barred by the statute of limitations set fourth in I.R.C. §6511(d)(2). I agree with defendant.

Before a refund action may be commenced in federal court, a taxpayer must file a claim for refund with the Secretary of the Treasury. *See* 26 U.S.C. §7422. A refund claim filed with the Secretary is a jurisdictional prerequisite to a refund action in a district court. *United States v. Felt & Tarrant Mfg. Co.*, 283 U.S. 269, 273 (1931).

The claim to be filed with the Secretary must meet the time

requirements of I.R.C. §6511(d)(2). That section provides that a claim for refund with respect to an overpayment attributable to a net operating loss carryback must be filed by the taxpayer within three years from the time for filing the return. *See* 26 U.S.C. §6511(d)(2).

Plaintiffs filed their claims for refund on July 10, 1991. The tax returns for tax years 1986 and 1987 were due (barring any extensions) on April 15, 1987, and April 15, 1988, respectively. Therefore, any claim for refund based on the 1986 tax year must have been filed by April 15, 1990, and any claim for tax year 1987 must have been filed by April 15, 1991. Plaintiffs failed to meet the statutory deadline; thus, the claims for tax years 1986 and 1987 are barred by the statute of limitations.

Plaintiffs assert that the limitations period set by §6511 for tax loss carryback refunds is tolled while the taxpayer's bankruptcy case is open. In support of this contention, plaintiffs rely on §346(i)(2) of the Bankruptcy Code. Section 346(i)(2) provides that, when a bankruptcy case is closed, a debtor will succeed to any tax attributes and may use such attributes as though any time limitations were suspended during the time in which the bankruptcy case was pending. That section is, however, subject to limits placed by §346(a) on a debtor under the Internal Revenue Code:

> Except to the extent otherwise provided in this section, subsections (b), (c), (d), (e), (h), (i), and (j) of this section apply notwithstanding any State or local law imposing a tax, but subject to the Internal Revenue Code. . . .

Appendix B

11 U.S.C. §346(a).

Consequently, §346(i) is still subject to the Internal Revenue Code and does not supersede any of the Code's provisions, including those of §6511(d)(2). Thus, despite the tolling allowed under §346(i), plaintiffs had to comply with the three year limitations period of §6511 of the Internal Revenue Code. *See In re Page,* 163 B.R. 196, 197 (Bankr. D. Kan. 1994) (holding that subsection (i) of §346, along with most of the rest of the statute is still subject to the IRC and thus, the statutory period for filing a refund claim with the IRS based on NOL's is not tolled while the bankruptcy case is pending).

Plaintiff argues that *In re Page* is from a bankruptcy court in a different district and is, therefore, "not directly determinative" of the issue in this district. (Doc. 16, p. 2). While *In re Page* is certainly not binding precedent, I find that it embodies the better view on the issue of whether a bankruptcy case tolls the IRC's statute of limitations. Both the legislative history and a leading bankruptcy treatise support the reading given by *In re Page,* and the language of §346(a) itself is clear and conclusive. *See* H.R.Rep. No. 595, 95th Cong., 1st Sess. 334 (1977), reprinted in 1978 U.S.C.A.A.N. 5963, 6290; S.Rep. No. 989, 95th Cong., 2d Sess. 44 (1978), reprinted in 1978 U.S.C.A.A.N. 5787, 5830; 124 Cong.Rec. H11092, 11109 (daily ed. September 28, 1978) (remarks of Rep. Edwards), reprinted in 1978 U.S.C.A.A.N. 6436, 6443, 6489; and 124 Cong.Rec. S17408, 17426 (daily ed. October 6, 1978) (remarks of Sen. DeConcini), reprinted in 1978 U.S.C.A.A.N. 6505, 6512, 6558; 2 *Collier on Bankruptcy,* ¶346.01 (15th ed. 1993). Furthermore, plaintiffs have cited no case law supporting their argument. Thus, this Court has the task of determining the issue based on the information before it and its evaluation of facts and legal

policy. Accordingly, I agree with the analysis announced in *In re Page*, and find that §346(i) is subject to the IRC.

Plaintiffs further state that they were precluded from filing any claim for refund within the limitations period because their bankruptcy case was pending while the statute of limitations was running. However, there is no stated exception to the limitations period of §6511 for individuals in the plaintiffs' situation.

Net operating loss carryforwards are property of the estate, and thus the trustee is allowed to use the loss carryforwards on the estate's tax returns. *In re Beery*, 116 B.R. 808 (Bankr. D. Kan. 1990). There is no injustice in failing to toll the statute of limitations while the bankruptcy is pending because the NOL's were at all times available for the trustee's use during the pendency of the bankruptcy case; use of the NOL's was not lost or postponed because of the pending bankruptcy.

Plaintiffs next argue that the United States has waived its statute of limitations defense because the Internal Revenue Service ("IRS") executed an "Agreement to Extend Time to Bring Suit." I am not persuaded by plaintiffs' argument. As stated above, on July 10, 1991, plaintiffs filed amended joint tax returns for tax years 1986, 1987, 1988, and 1989, claiming the refunds based on NOL's reported by the trustee. On September 16, 1991, the IRS denied plaintiffs' claims for refund and told them that they had two years in which to "bring suit or proceedings to recover any tax, penalties, or other amounts for which [the] disallowance notice [was] issued." (Doc. 14, Exh. 11). Thus, plaintiffs had until September 16, 1993, in which to file suit. This was the time period extended by the "Agreement to Extend Time to Bring Suit." Specifically, this agreement

extended the time for which the plaintiffs could bring an action in federal court from September 16, 1993 to June 30, 1994.

This extension of time is unrelated to the §6511 statute of limitations. In addition to the limitations period under §6511. which requires a claim to be filed with the Secretary of the Treasury within three years, a taxpayer must also comply with the time limits of I.R.C. §6532(a). Once a taxpayer files a claim with the Secretary and that claim is disallowed, a taxpayer has two years from the date the Secretary mails the taxpayer a notice of disallowance in which to bring an action in federal court. 26 U.S.C. §6532(a)(1). This period, however, may be extended by agreement between the taxpayer and the IRS.

The agreement between plaintiffs and the IRS was unrelated to the statute of limitations prescribed by §6511, which requires a *claim* to be filed within three years of the date the tax return must be filed. Thus, regardless of the agreement entered into between the taxpayer and the IRS, plaintiffs were still required to file a timely claim with the Secretary of the Treasury. Plaintiffs failed to follow this statutory requirement, and their claims for tax years 1986 and 1987 are time-barred.

III.

The refund claims for tax years 1988 and 1989 must also be denied because plaintiffs were not entitled to carry forward their net operating losses under I.R.C. §108. In *United States v. Kirby Lumber Co.*, 284 U.S. 1 (1931), the Supreme Court announced the general rule that gross income includes income from the discharge of indebtedness. Section 61(a)(12) of the Internal Revenue Code provides that gross income means gross income from whatever source derived, and it specifically

provides that gross income includes income from the discharge of indebtedness.

Section 108(a)(1), however, carves out two important exceptions. Pursuant to §108, gross income does not include income from cancellation of indebtedness if the discharge occurs in a Title 11 case[1] or the discharge occurs when the taxpayer is insolvent.

Section 108(b) further provides that the amount excluded from income under §108(a)(1) must be applied to reduce certain tax attributes of the taxpayer, including net operating losses.[2] Tax attributes are deducted one dollar for each dollar of the debt discharge amount. 26 U.S.C. §108(b)(3)(A). The Committee Reports on I.R.C. §108 state:

> The rules ... concerning income tax treatment of debt discharge in bankruptcy are intended to accommodate bankruptcy

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1. Plaintiffs argue that §108 does not apply in this case. They claim that since their discharge occurred in a Chapter 7 case and §108(a)(1) only refers to Title 11 cases, they are not covered by its terms. However, plaintiffs are mistaken as to the meaning of "Title 11." Section 108(d)(2) defines the term "Title 11 case" as "a case under Title 11 of the United States Code (relating to bankruptcy), but only if the taxpayer is under the jurisdiction of the court in such a case and the discharge of indebtedness is granted by the court or is pursuant to a plan approved by the court." Thus, because Title 11 of the United States Code encompasses both *Chapter* 11 and *Chapter* 7 cases, §108 is certainly relevant to plaintiffs' case.

2. A taxpayer may also elect to reduce his or her basis in depreciable assets or real property held primarily for sale to customers in the ordinary course of business. *See* 26 U.S.C. §108(b)(5).

> policy and tax policy and tax policy. To preserve the debtor's "fresh start" after bankruptcy, . . . no income is recognized by reason of the debt discharge in bankruptcy, so that a debtor coming out of bankruptcy (or an insolvent debtor outside bankruptcy) is not burdened with immediate tax liability. The . . . debt discharge amount thus excluded from income is applied to reduce net operating losses and certain other tax attributes. . . .

See also, CSI Hydrostatic Testers, Inc. v. Commissioner, 103 T.C. No. 21 (1994).

Plaintiffs argue that §108(b)(1) is inapplicable to them because they are not "the taxpayer" to which §108(b)(1) applies. Plaintiffs rely on §108(d)(8) to support this theory. Section 108(d)(8) states, "[i]n any case under Chapter 7 or 11 of title 11 of the United States Code . . . , for purposes of paragraphs (1) and (5) of subsection (b) the estate (and not the individual) shall be treated as the taxpayer." Plaintiffs claim that the estate *i.e.*, the bankruptcy trustee — and not the individual — is required to reduce NOL's by the amount of debt discharged. Even though the trustee did not reduce the NOL's, plaintiffs claim that, because they are not considered the "taxpayer" under §108(d)(8), they are not required to reduce their NOL's.

This argument is without merit. To accept plaintiffs' reading of the statute would put form ahead of substance — allowing plaintiffs the benefit of the NOL's simply because the trustee did not make an accounting entry to reduce the NOL's. Consequently, I find that the debt discharge amount excluded

from plaintiffs' income is applied to reduce their NOL's. To hold otherwise would defeat the intent of §108, and would allow plaintiffs a double benefit — a discharge of debt with no gross income consequences, and succession to tax attributes, *i.e.*, net operating losses, from the bankruptcy estate.

In the case at bar, it is very unlikely that the NOL's available to the estate before the §108 attribute reduction exceed the amount of debt discharged in the bankruptcy proceedings. Furthermore, plaintiffs have offered no evidence that NOL's remain after reduction in NOL's. Because plaintiffs have the burden of proof in this refund litigation, *Coleman v. United States,* 704 F.2d 326, 328 (6th Cir. 1983), and they have failed to show that the amount of debt discharged in their bankruptcy case was less than the NOL's that they succeeded to, and because they have failed to allege the actual amount to which they are entitled, *Missouri Pac. R.R. Co. v. United States,* 168 Ct. Cl. 86, 338 F.2d 668, 671 (Ct. Cl. 1964), their claim for a tax refund is denied. *See Burnet v. Houston,* 283 U.S. 223 (1931).

Accordingly, I find that the refund claims for tax years 1986 and 1987 are barred by the applicable statute of limitations. I further find that the refund claims for tax years 1988 and 1989 are also without merit because NOL's have been reduced by virtue of the taxpayers' discharge of indebtedness pursuant to I.R.C. §108. Thus, the United States' motion for summary judgment should be granted.

Appendix B

It is, accordingly,

ORDERED THAT defendant's motion for summary judgment be and the same hereby is granted.

SO ORDERED.

s/ illegible
United States District Judge

APPENDIX C — RELEVANT STATUTES

26 U.S.C. § 108

§ 108. Income from discharge of indebtedness

(a) Exclusion from gross income —

(1) In general. — Gross income does *not* include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if —

(A) the discharge occurs in a title 11 case,

(B) the discharge occurs when the taxpayer is insolvent, or

(C) the indebtedness discharged is qualified business indebtedness.

* * *

(b) Reduction of tax attributes in title 11 case or insolvency. —

(1) In general. — The amount excluded from gross income under subparagraph (A) or (B) of subsection (a)(1) shall be applied to reduce the tax attributes of the taxpayer as provided in paragraph (2).

(2) Tax attributes affected: order of reduction. — Except as provided in paragraph (5), the reduction referred to in paragraph (1) shall be made in the following tax attributes in the following order:

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(A) NOL. — Any net operating loss for the taxable year of the discharge, and any net operating loss carryover to such taxable year.

(B) Research credit and general business credit. — Any carryover to or from the taxable year of a discharge of an amount for purposes of determining the amount allowable as a credit under —

(i) section 30 (relating to credit for increasing research activities), or

(ii) section 38 (relating to general business credit).

For purposes of this subparagraph, there shall not be taken into account any portion of a carryover which is attributable to the employee stock ownership credit determined under section 41.

(C) Capital loss carryovers. — Any net capital loss for the taxable year of the discharge, and any capital loss carryover to such taxable year under section 1212.

(D) Basis reduction. —

(i) In general. — The basis of the property of the taxpayer.

(ii) Cross reference. —

For provisions for making the reduction described in subparagraph (A), see section 1017.

(E) Foreign tax credit carryovers. — Any carryover to or from the taxable year of the discharge for purposes of determining the amount of the credit allowable under section 33.

(3) Amount of reduction. —

(A) In general. — Except as provided in subparagraph (B), the reductions described in paragraph (2) shall be one dollar for each dollar excluded by subsection (a).

(B) Credit carryover reduction. — The reduction described in subparagraphs (B) and (E) of paragraph (2) shall be 50 cents for each dollar excluded by subsection (a).

(4) Ordering rules. —

(A) Reductions made after determination of tax for year. — The reductions described in paragraph (2) shall be made after the determination of the tax imposed by this chapter for the taxable year of the discharge.

(B) Reductions under subparagraph (A) or (C) of paragraph (2). — The reductions described in subparagraph (A) or (C) of paragraph (as the case may be) shall be made first in the loss for the taxable year of the discharge and then in the carryovers to such taxable year for the order of the taxable years from which each such carryover arose.

(C) Reductions under subparagraphs (B) and (E) of paragraph (2). — The reductions described in subparagraphs (B) and (E) of paragraph (2) shall be made in the order in which carryovers are taken into account under the chapter for the taxable year of the discharge.

Appendix C

(5) Election to apply reduction first again depreciable property. —

(A) In general.— The taxpayer may elect to apply any portion of the reduction referred in paragraph (1) to the reduction under section 1017 of the basis of the depreciable property of the taxpayer.

(B) Limitation. — The amount to which a election under subparagraph (A) applies shall not exceed the aggregrate adjusted bases of the depreciable property held by the taxpayer as of the beginning of the taxable year following the taxable year in which the discharge occurred.

(C) Other tax attributes not reduced. — Paragraph (2) shall not apply to any amount to which an election under this paragraph applies.

* * *

(d) Meaning of terms: special rules relating to subsections (a), (b), and (c). —

* * *

(8) Reductions of tax attributes in title 11 cases of individuals to be made by estate. — In any case under chapter 7 or 11 of title 11 of the United States Code to which section 1398 applies, for purposes of paragraphs (1) and (5) of subsection (b) the estate (and not the individual) shall be treated as the taxpayer. The preceding sentence shall not apply for purposes of applying section 1017 to property transferred by the estate to the individual.

* * *

Appendix C

Internal Revenue Code 26 U.S.C. § 6511

§ 6511. Limitations on credit or refund

(a) Period of limitation on filing claim. — Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid. Claim for credit or refund of an overpayment of any tax imposed by this title which is required to be paid by means of a stamp shall be filed by the taxpayer within 3 years from the time the tax was paid.

* * *

(d) Special rules applicable to income taxes —

(2) Special period of limitation with respect to net operating loss or capital loss carrybacks. —

(A) Period of limitation. — If the claim for credit or refund relates to an overpayment attributable to a net operating loss carryback or a capital loss carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends 3 years after the time prescribed by law for filing the return (including extensions thereof) for the taxable year of the net operating loss or net capital loss which results in such carryback, or the period prescribed in subsection (c) in respect of such taxable year, whichever expires later; except that with respect to an overpayment attributable to the

creation of or an increase in a net operating loss carryback as a result of the elimination of excessive profits by a renegotiation (as defined in section 1481(a)(1)(A)), the period shall not expire before the expiration of the 12th month following the month in which the agreement or order for the elimination of such excessive profits becomes final. In the case of such a claim, the amount of the credit or refund may exceed the portion of the tax paid within the period provided in subsection (b)(2) or (c), whichever is applicable to the extent of the amount of the overpayment attributable to such carryback.

(B) Applicable rules. —

(i) In general. — If the allowance of a credit or refund of an overpayment of tax attributable to a net operating loss carryback or a capital loss carryback is otherwise prevented by the operation of any law or rule of law other than section 7122 (relating to compromises), such credit or refund may be allowed or made, if claim therefor is filed within the period provided in subparagraph (A) of this paragraph.

(ii) Tentative carryback adjustments. — If the allowance of an application, credit, or refund of a decrease in tax determined under section 6411(b) is otherwise prevented by the operation of any law or rule of law other than section 7122, such application, credit, or refund may be allowed or made if application for a tentative carryback adjustment is made within the period provided in section 6411(a).

(iii) Determinations by courts to be conclusive. — In the case of any such claim for credit or refund or any such application for a tentative carryback adjustment, the determination by any court, including the Tax Court, in any

proceeding in which the decision of the court has become final, shall be conclusive except with respect to —

(I) the net operating loss deduction and the effect of such deduction, and

(II) the determination of a short-term capital loss and the effect of such short-term capital loss, to the extent that such deduction or short-term capital loss is affected by a carryback which was not an issue in such proceeding.

* * *

Bankruptcy Code 11 U.S.C. § 346

§ 346. Special tax provisions

(a) Except to the extent otherwise provided in this section, subsections (b), (c), (d), (e), (g), (h), (i), and (j) of this section apply notwithstanding any State or local law imposing a tax but subject to the Internal Revenue Code of 1986.

(b)(1) In a case under chapter 7, 12 or 11 of this title concerning an individual, any income of the estate may be taxed under a State or local law imposing a tax on or measured by income only to the estate, and may not be taxed to such individual. Except as provided in section 728 of this title, if such individual is a partner in a partnership, any gain or loss resulting from a distribution of property from such partnership, or any distributive share of income, gain, loss, deduction, or credit of such individual that is distributed, or considered

distributed from such partnership, after the commencement of the case is gain, loss, income, deduction, or credit, as the case may be, of the estate.

* * *

(i)(1) In a case under chapter 7, 12, or 11 of this title concerning an individual, the estate shall succeed to the debtor's tax attributes, including —

(A) any investment credit carryover;

(B) any recovery exclusion;

(C) any loss carryover;

(D) any foreign tax credit carryover;

(E) any capital loss carryover; and

(F) any claim of right.

(2) After such a case is closed or dismissed, the debtor shall succeed to any tax attribute to which the estate succeeded under paragraph (1) of this subsection but that was not utilized by the estate. The debtor may utilize such tax attributes as though any applicable time limitations on such utilization by the debtor were suspended during the time during which the case was pending.

* * *

Appendix C

Bankruptcy Code 11 U.S.C. § 505

§ 505. Determination of tax liability

(a)(1) Except as provided in paragraph (2) of this subsection, the court may determine the amount or legality of any tax, any fine or penalty relating to a tax or any addition to tax whether or not previously assessed whether or not paid and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.

(2) The court may not so determine —

(A) the amount of legality of a tax fine, penalty, or addition to tax if such amount or legality was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under this title; or

(B) any right of the estate to a tax refund before the earlier of —

(i) 120 days after the trustee properly requests such refund from the governmental unit from which such refund is claimed; or

(ii) a determination by such governmental unit of such request.

(b) A trustee may request a determination of any unpaid liability of the estate for any tax incurred during the administration of the case by submitting a tax return for such tax and a request for such a determination to the governmental unit charged with responsibility for collection or determination

of such tax. Unless such return is fraudulent, or contains a material misrepresentation, the trustee the debtor, and any successor to the debtor are discharged from any liability for such tax —

(1) upon payment of the tax shown on such return, if —

(A) such governmental unit does not notify the trustee, within 60 days after such request, that such return had been selected for examination; or

(B) such governmental unit does not complete such an examination and notify the trustee of any tax due within 180 days after such request or within such additional time as the court for cause, permits;

(2) upon payment of the tax determined by the court after notice and a hearing, after completion by such governmental unit of such examination; or

(3) upon payment of the tax determined by such governmental unit to be due.

* * *